MOTION FILED
FEB 1 2 1996

No. 95-984

(5)

IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY,
Petitioner,
v.
STATE OF NEW JERSEY, COMMISSIONER OF INSURANCE, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the Superior Court of New Jersey, Appellate Division

---

MOTION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE OUT OF TIME AND BRIEF OF AMICUS CURIAE STATE OF ILLINOIS IN SUPPORT OF THE PETITION

HONORABLE JAMES RYAN *
Attorney General
BARBARA PREINER
Solicitor General
State of Illinois
James R. Thompson Center
100 West Randolph Street
Chicago, Illinois 60601
(312) 814-2503

ROBERT N. ENOEX
Special Assistant
Attorney General
Chief Counsel
Illinois Department of Insurance
320 West Washington Street
Springfield, Illinois 62767
(217) 782-0007

Counsel for Amicus Curiae
State of Illinois

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

No. 95-984

STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY,

Petitioner,

v.

STATE OF NEW JERSEY, COMMISSIONER OF INSURANCE, *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the Superior Court of New Jersey, Appellate Division

MOTION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE OUT OF TIME

Pursuant to S. Ct. Rule 37.5, the State of Illinois, through its Attorney General, respectfully moves for leave to file the accompanying brief of amicus curiae in support of the petition out of time.

1. This case is a matter of great importance to the State of Illinois. The decision below, and the developing trend it embodies, will have profound effects beyond the borders of the state in which it arose. If an insurance company doing business nationwide is denied the opportunity to recover its reasonable cost of capital in a particular state, policyholders in other states will bear the burden as funds that would otherwise cover risks in those states are diverted to cover the cost of capital shortfall.

2. The decision below in effect harms Illinois policyholders—and policyholders in other states—to subsidize New Jersey policyholders. The Takings Clause of the United States Constitution should preclude such confisca-

tory rate regulation, but the court below circumvented that hurdle by abandoning the cost of capital standard for determining when rate regulation goes too far and becomes a taking. That standard—employed by this Court and the lower courts since at least *Federal Power Comm'n* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944)—establishes a uniform national measure applicable in every state. It ensures that no one state will be able to enrich itself and its resident policyholders by taking the property of a nationwide insurer, to the detriment of policyholders in other states.

3. The court below expressly rejected the cost of capital standard. In doing so it relied on the recent California Supreme Court decision in *20th Century Ins. Co.* v. *Garamendi*, 8 Cal. 4th 216, 878 P.2d 566, 32 Cal. Rptr. 2d 807 (1944), *cert. dismissed*, 115 S. Ct. 1085 (1995), *cert. denied*, 115 S. Ct. 1106 (1995). That decision poses the same problem of extraterritorial impacts on policyholders in other states. This growing trend is a matter of grave concern to the State of Illinois.

4. Because the decision below, like that in *20th Century*, is based on a new interpretation of the Takings Clause, only this Court can resolve the growing conflict. The State of Illinois firmly believes this Court should grant certiorari to do so, and to reaffirm that there is a uniform standard—cost of capital—for measuring when rate regulation goes too far and becomes a taking.

5. The opposition to certiorari was due in this case and filed on February 5, 1996. Pursuant to S. Ct. Rule 37.2, that day was also the due date for amicus filings in support of the petition.

6. The State of Illinois does not regularly participate as an amicus curiae at the certiorari stage in matters before this Court. The decision whether to take the unusual step to do so required considerable consultation among state officials, not only within the Office of the Attorney General but within the Department of Insurance as well. That proc-

ess was hampered by the extraordinarily harsh weather befalling the Midwest over the past several weeks. In light of the foregoing, we were unable to complete and print the accompanying brief in time for filing by February 5, 1996. Nonetheless, in view of the importance to the State of the issue, we determined to proceed to seek leave to file the brief.

7. This Court has on prior occasions granted motions for leave to file briefs of amici curiae out of time. *See United States* v. *Salerno*, 479 U.S. 1015 (1986) (motion of American Bar Association); *International Union, United Automobile Workers* v. *Brock*, 475 U.S. 1093 (1986) (motion of Chamber of Commerce, AFL-CIO, NAACP, Sierra Club, *et al.*). The briefs in the instances just cited were filed by private organizations. We respectfully submit that the Court should show a similar willingness to entertain the views expressed by the State of Illinois in the accompanying brief.

Respectfully submitted,

HONORABLE JAMES RYAN *
Attorney General
BARBARA PREINER
Solicitor General
State of Illinois
James R. Thompson Center
100 West Randolph Street
Chicago, Illinois 60601
(312) 814-2503

ROBERT N. ENOEX
Special Assistant
Attorney General
Chief Counsel
Illinois Department of Insurance
320 West Washington Street
Springfield, Illinois 62767
(217) 782-0007
Counsel for Amicus Curiae
State of Illinois

* Counsel of Record

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTRODUCTION	1
STATEMENT OF INTEREST OF AMICUS CURIAE	2
STATEMENT OF THE CASE	3
SUMMARY OF ARGUMENT	4
ARGUMENT	5
THE "NATIONAL INDUSTRY AVERAGE" RATE APPROVAL STANDARD APPLIED BY THE NEW JERSEY COURTS IS INCONSISTENT WITH THIS COURT'S "COST OF CAPITAL" STANDARD UNDER THE FIFTH AND FOURTEENTH AMENDMENTS AND DENIES EQUAL PROTECTION AND DUE PROCESS TO INSURANCE CONSUMERS IN OTHER STATES	5
A. The "National Industry Average" Standard for Reviewing Confiscatory Ratemaking Claims Conflicts With the Standard Set Out By This Court	5
B. The Failure to Adhere to the Prior Standards of This Court In Resolving Claims of Unconstitutional Takings Would Have a Discriminatory Impact Upon Insureds Located In Other Jurisdictions and Diminish the Viability of the National Insurance Market	7
CONCLUSION	11

TABLE OF AUTHORITIES

Cases Page

20th Century Ins. Co. v. *Garamendi*, 8 Cal. 4th 216, 878 P.2d 566, 32 Cal. Rptr. 2d 807 (1994), *cert. dismissed*, 115 S. Ct. 1085 (1995), *cert. denied*, 115 S. Ct. 1106 (1995) 9
Aetna Insurance Co. v. *Hyde*, 275 U.S. 440 (1928) .. 5
Duquesne Light Co. v. *Barasch*, 488 U.S. 299 (1989) 5-6, 10
Federal Power Comm'n v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944) 5, 6, 7, 10
State Farm Mut. Auto. Ins. Co. v. *State*, 124 N.J. 32, 590 A.2d 191 (1991) 3

Constitutional and Regulatory Provisions

U.S. Const. amend. V 1, 2, 4, 5, 10
U.S. Const. amend. XIV 4, 5
N.J.S.A. 17:33B-1 *et seq.* 3

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

No. 95-984

STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY,

Petitioner,

v.

STATE OF NEW JERSEY, COMMISSIONER OF INSURANCE, *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the Superior Court of New Jersey, Appellate Division

---

BRIEF OF AMICUS CURIAE STATE OF ILLINOIS IN SUPPORT OF THE PETITION

INTRODUCTION

This Court has repeatedly held that the Takings Clause of the Fifth Amendment to the United States Constitution is violated when a State does not permit a company in a regulated industry to set its rates such that it earns sufficient revenue for operating expenses and the cost of capital. In a decision that could change the course of rate regulation in regulated industries, the Superior Court of New Jersey, Appellate Division, has concluded that a New Jersey law that imposed an assessment and did not allow the company to pass on the cost of that assessment, even

when the company proved that its returns were below the cost of capital, does not violate the Takings Clause. The Superior Court of New Jersey, Appellate Division, concluded that the Takings Clause is satisfied as long as the regulated entity has achieved a rate of return equal to or greater than the annual nationwide average return for that industry. This standard, which is not supported by any of this Court's decisions, could threaten the solvency of insurance companies that are forced to comply with rates that are set and approved pursuant to it, and in turn threaten the viability of insurance policies of consumers in many states. Therefore, this Court should reverse the decision of the New Jersey Superior Court, Appellate Division and remand the case to require New Jersey to use the correct standard to determine whether an imposed rate is confiscatory.

STATEMENT OF INTEREST OF AMICUS CURIAE

Amicus is the State of Illinois. Under the laws of the State of Illinois, the Director of Insurance is responsible for regulation of the insurance industry. One of the main purposes of that regulation is protecting the interests of insurance consumers in the State. The decision of the New Jersey Court, Appellate Division constitutes a direct threat to those interests.

The New Jersey Court's decision in this case announced a new standard for judicial review of challenges to ratemaking that will threaten the financial position of insurers that operate throughout the nation. The impact of that decision on those insurers will adversely affect the ability of consumers in other states to secure viable insurance products at competitive rates. Amicus submits this brief to explain the nationwide consequences of the New Jersey Court's decision. These consequences counsel strongly in favor of this Court's review.

STATEMENT OF THE CASE

In 1990, New Jersey adopted the Fair Automobile Insurance Reform Act, N.J.S.A. 17:33B-1 *et seq.* This Act provided that the operating deficit of the Joint Underwriting Association [JUA] would be paid off in large part through surtaxes and assessments imposed on insurance companies licensed to write automobile insurance in New Jersey. The Act explicitly provided that the surtaxes and assessments could not be passed through into the premiums that were charged by these companies to New Jersey drivers.

A facial challenge to this statute was rejected by the New Jersey Supreme Court in *State Farm Mut. Auto. Ins. Co. v. State of New Jersey*, 124 N.J. 32, 590 A.2d 191 (1991). The court held that because there were procedures put in place to allow insurers to apply for adjustments to their rates, the proper method to raise the constitutional issue was to apply for an adjustment and ask for a review of that adjustment. *Id.* at 63, 590 A.2d at 207. State Farm then applied to the Commissioner for the adjustment.

The first decision of the Administrative Law Judge was a ruling that State Farm's request constituted impermissible "retroactive ratemaking." *See* Pet. App. at 116a. This decision was overturned, and the case was remanded to the ALJ. The ALJ concluded that the fair rate of return for the period in question was approximately 13%, and that after consideration of the surtaxes and assessments, State Farm's earnings were 3.4% for 1990 and 7.5% for 1991. The ALJ concluded that because these figures were within a "confidence interval," the constitutional standard was satisfied. Pet. App. at 91a-92a.

On review, the Appellate Division of the New Jersey Superior Court concluded that even though State Farm's earnings were below the cost of capital, that standard was only useful as a "prospective" concept. Pet. App. at 9a. The court went on to hold that when it was deciding whether there had been confiscatorily low rates in the past,

the appropriate standard was not the reasonable cost of capital but rather the nationwide industry average return. Pet. App. at 23a. A timely petition for certification to the New Jersey Supreme Court was denied. Pet. App. at 43a.

SUMMARY OF ARGUMENT

The position of the State of Illinois focuses upon the need for the uniform interpretation and application of the Takings Clause of the Fifth Amendment to the United States Constitution as applied to the states through the Fourteenth Amendment to the United States Constitution. Without such uniformity, Illinois foresees the continuation of a trend wherein a State is able to pass the costs of its local governmental programs to the residents of other states. Some states have begun to develop fees, assessments, taxes and surcharges based on premiums collected by insurers in their jurisdictions which differ from the historic forms of insurance taxes in that the insurers are then denied the opportunity to include such charges in their rate base. To the extent that such fees and taxes exceed the constitutional limits imposed on the states by the Takings Clause, they constitute an unlawful shift of a governmental tax burden from the taxing state to citizens of other states.

Illinois submits that this trend works a deprivation of the rights of equal protection and due process upon the residents of other States, when the insurers who pay the offending fee or tax are also engaged in the business of insurance in those other states. This poses a long-term threat to the continued existence of the national system of insurance regulation. For this reason, Illinois asks this Court to grant the Petition for Writ of Certiorari and reverse the decision of the New Jersey Court.

ARGUMENT

THE "NATIONAL INDUSTRY AVERAGE" RATE APPROVAL STANDARD APPLIED BY THE NEW JERSEY COURTS IS INCONSISTENT WITH THIS COURT'S "COST OF CAPITAL" STANDARD UNDER THE FIFTH AND FOURTEENTH AMENDMENTS AND DENIES EQUAL PROTECTION AND DUE PROCESS TO INSURANCE CONSUMERS IN OTHER STATES.

A. The "National Industry Average" Standard for Reviewing Confiscatory Ratemaking Claims Conflicts With the Standard Set Out By This Court.

When a party claims a deprivation of rights under the Takings Clause of the Fifth Amendment and Fourteenth Amendment,

> the facts relied on to restrain the enforcement of rates prescribed under the sanction of state law must be specifically set forth, and from them it must clearly appear that the rates would necessarily deny to the plaintiff just compensation and deprive it of its property without due process of law.

Aetna Insurance Co. v. Hyde, 275 U.S. 440, 447 (1928). In *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), this test was further refined by this Court's holding that:

> It is not the theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then important.

Id. at 602. This attempt to simplify an inordinately complex analysis was recognized as necessary, but not fully dispositive in *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989), where it was held that:

> This language, of course, does not dispense with all constitutional difficulties when a utility raises a claim that the rate which it is permitted to charge is so low

> as to be confiscatory; whether a particular rate is "unjust" or "unreasonable" will depend to some extent on what is a fair rate of return given the risks under a particular ratesetting system, and on the amount of capital upon which the investors are entitled to earn that return. *Id.* at 310.

This case provides this Court with a clear opportunity to affirm and explain the applicability of the foregoing standards to ratemaking in the regulation of the business of insurance. As the Petition For a Writ of Certiorari filed in this matter demonstrates, State Farm has plead with specificity that it has been subjected to a retroactive rate by the state denying it a fair rate of return. That plea is supported by the very record of findings on which the State of New Jersey has based its applied rate.

The field of insurance is a competitive business in which there is a broad range of success and failure as indicated by the industry variable returns referenced by all parties on the record. This is not a case, as in *Hope* and *Duquesne,* where a monopoly enterprise was guaranteed a market. This is a case in which State Farm and other insurers compete on the basis of price and service and it is only through such competition that they are able to obtain and maintain the capital necessary to remain in business. New Jersey has established a precedent whereby it may visit the health insurance industry, the liability insurance market, or any other competitive insurance market and demand any amount of funds it sees fit to cure virtually any perceived deficiency in a state-mandated program.

We assert, rather, that the standards decreed by *Hope* and *Duquesne* must, at minimum, stand for the proposition that a company cannot be denied the opportunity to earn a return on capital by state action. Although this Court has ruled that no company is guaranteed a profit, it has certainly never approved of any ratemaking standard which could be used just as easily to deny even the opportunity for a profit.

B. The Failure to Adhere to the Prior Standards of This Court in Resolving Claims of Unconstitutional Takings Would Have a Discriminatory Impact Upon Insureds Located In Other Jurisdictions and Diminish the Viability of the National Insurance Market.

One difference between the insurance market system and the regulated monopoly or utility market systems considered in *Hope* is that ratemaking in the insurance industry involves hundreds of firms with national operations which are subjected to the rate regulatory policies of each of the fifty states. Because ratemaking methodology requires considering the capital costs of an insurer wherever it may engage in sales, each state has a vested interest in the uniform application of constitutional standards to the ratemaking activities of other states.

This concern is most obvious when considered from the standpoint of underwriting losses, as opposed to ultimate return on capital. Should the property and casualty industry be struck by catastrophic wind storms in Midwestern states, but not be allowed to recover its losses on policies issued in the Midwest, profits generated elsewhere in states with few losses will necessarily subsidize the high loss jurisdictions. Similarly, high losses to insurers in a hurricane prone area may be subsidized by insureds elsewhere if rates in the high loss area are inadequate to support the loss generated. This is an inherent feature of the insurance system because all insurers, whether national or regional, must go to the same financial markets for capital. Expenses, whether allocated as administrative, a tax or assessment, or claims, all have the same effect on the investor.

As a result, Illinois operates on the assumption that the regulators of other jurisdictions will be subject to a uniform application of the constitutional restriction on takings by a government action. Were one state allowed a more liberal authority to obtain the benefit of an insurer's capital by any means, it would result in the policyholders of other states carrying the added burden of making up the

shortfall for any insurer doing business in both locations. This is generally accepted as a good thing in the case of infrequent and fortuitous underwriting losses. It allows the risk of localized catastrophes to be spread across the entire industry and economy. The risk of insolvency and reduced insurance capacity is lessened by this system. It is sometimes found to be unworkable when the underwriting risk is either so severe, so frequent or both that there is no possibility of the insured population paying the premium required to support the coverage. This has always been the case in the nuclear industry and is becoming more prevalent in a number of other lines of business.

It has never been accepted as beneficial for insurers or consumers to have such risks spread across the insurance industry when they are the result of government policy rather than fortuitous underwriting *losses.* Such cases are outside the business of insurance. Rather than a business where insurers and consumers enter contracts to protect against fortuitous events, such events are purely a matter of social welfare and taxation.

In the present case a former New Jersey administration established and regulated a residual market mechanism for high risk automobile insureds. By its policies it precluded the collection of insurance premiums adequate to support the loss incurred by its citizens eligible to participate in that program. Before bringing an inevitable halt to this program, a backlog of unpaid liabilities amounting to $3.3 billion dollars was accrued. No one can seriously claim that losses of this magnitude were not foreseen years before the program was closed. The claims incurred were no more fortuitous than a creditor's claim when a bill goes unpaid. Nor were they the result of any unlawful or inappropriate conduct by the insurance industry. To lay this at the feet of insurers would be tantamount to charging a Medicaid deficit to the health insurance industry because it failed to insure the indigent in need of health care. The assessment and surcharge imposed here must be considered even worse. Unlike such a hypothetical

distribution of the cost of Medicaid, New Jersey's action here is neither uniform in its distribution of costs, nor does it result in any benefit to the residents and citizens of any other state.

Illinois does not wish to prohibit New Jersey or any other state from enacting such social welfare or public programs as it sees fit. Nor does it want to undermine efforts in other jurisdictions to assess the costs of its government policies to insurers within constitutional limits. If a state can maintain a viable insurance market while imposing constitutional taxes or assessments on the insurance industry, that is its right. Illinois does object when another state employs the national system of state regulation to spread its costs for such programs to our residents and insurance consumers by denying just compensation to insurers operating in both our states.

The use of the insurance industry for purposes of funding local programs of a governmental nature has become a trend since the decision in *20th Century Ins. Co. v. Garamendi,* 8 Cal. 4th 216, 878 P.2d 566, 32 Cal. Rptr. 2d 807 (1994), *cert. dismissed,* 115 S. Ct. 1085 (1995), *cert. denied,* 115 S. Ct. 1106 (1995). In *20th Century,* the state of California used a test of "deep financial hardship" rather than the wide "reasonable range" derived by industry average presented here. The effect is necessarily the same under the national system of insurance regulation. Under neither standard is there a basis for concluding that an insurer subject to them has an opportunity to make a reasonable return on capital.

These cases represent a new development. The states involved seek to impose after-the-fact assessments to fund state created and mandated programs either of premium refunds or residual market deficiencies which are entirely of the state's own making. There are now at least five (5) other states with laws enacting assessments serving purposes effectively the same as the New Jersey law which gives rise to this case.

If this Court fails to give some meaning to the Takings Clause in these cases, it will present a windfall of an enormous magnitude to any state which needs to fund a politically popular activity. Any state failing to implement such assessments will be at a financial disadvantage, as will its residents. The insurance industry will lose insuring capacity and the ability to remain in business will become problematic for many insurers. Well-capitalized insurers will see their surplus stripped to fund government efforts to find the proverbial free lunch.

There is no reasonable method of self-help regarding the redress of this dilemma. The only method of self-help available to protect Illinois residents would be to prohibit any insurer that does business in New Jersey to engage in insurance business in Illinois. There is no benefit to Balkanizing the insurance industry in this manner. An equally unsatisfactory result would follow any attempt to develop a special retaliatory law intended to penalize New Jersey insurers doing business in Illinois, to the same extent that any Illinois insurer doing business in New Jersey or other offending state has been forced to surrender excessive charges there.

Hypothetically, if funds were needed to provide retirement care for elderly New Jersey citizens, the State could pass an assessment against prior year's premiums of annuity writers. Assuming it is apportioned equally, relief would be granted only when a company's security is threatened, and the State would be free from constitutional attack. Such a standard must be rejected under any reasonable view of the Constitution. It amounts to a license to the states to take it all as long as you don't put the company out of business. Surely this was not intended by the *Hope* or *Duquesne* Courts, and this Court must reject this standard, and grant the Petitioner's Petition for Certiorari.

CONCLUSION

For the foregoing reasons, and those in the Petition for Certiorari, this Court should grant the writ and reverse the decision below.

Respectfully submitted,

HONORABLE JAMES RYAN *
Attorney General
BARBARA PREINER
Solicitor General
State of Illinois
James R. Thompson Center
100 West Randolph Street
Chicago, Illinois 60601
(312) 814-2503

ROBERT N. ENOEX
Special Assistant
Attorney General
Chief Counsel
Illinois Department of Insurance
320 West Washington Street
Springfield, Illinois 62767
(217) 782-0007

Counsel for Amicus Curiae
State of Illinois

* Counsel of Record